

INDEX

	Page
Opinions below-----	1
Jurisdiction-----	1
Questions presented-----	2
Statutes involved-----	2
Statement-----	3
Argument-----	7
Conclusion-----	11
Appendix-----	12

CITATIONS

Cases:

<i>Davidson v. Commissioner</i> , 305 U. S. 44-----	9
<i>Deputy v. du Pont</i> , 308 U. S. 488-----	8
<i>Drake, W. A., Inc. v. Commissioner</i> , 3 T. C. 33-----	7
<i>Lakeside Irr. Co. v. Commissioner</i> , 128 F. 2d 418, certiorari denied, 317 U. S. 666-----	7
<i>Mahaffey v. Commissioner</i> , 1 T. C. 176, reversed, 140 F. 2d 879-----	7
<i>Mathews v. Squire</i> , 59 F. Supp. 827-----	7
<i>Morris Inv. Corp. v. Commissioner</i> , 134 F. 2d 774, certiorari denied, 320 U. S. 743-----	10
<i>New Colonial Co. v. Helvering</i> , 292 U. S. 435-----	8
<i>Reddington, M. F., Co. v. Commissioner</i> , 131 F. 2d 1014-----	7
<i>United States v. Safety Car Heating Co.</i> , 297 U. S. 88-----	9
<i>White v. United States</i> , 305 U. S. 281-----	8

Statute:

Internal Revenue Code:	
Sec. 22 (26 U. S. C. 22)-----	7, 12
Sec. 24 (26 U. S. C. 24)-----	7, 8, 12
Sec. 27 (26 U. S. C. 27)-----	10, 13
Sec. 500, as amended (26 U. S. C. 500)-----	13
Sec. 501 (26 U. S. C. 501)-----	3, 7, 14
Sec. 504 (26 U. S. C. 504)-----	10, 14

(1)



In the Supreme Court of the United States

OCTOBER TERM, 1946

No. 651

MORRIS INVESTMENT CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR THE THIRD
CIRCUIT*

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 13-21)¹ are reported in 5 T. C. 583. The opinion of the Circuit Court of Appeals (R. 43-49) is reported in 156 F. 2d 748.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on July 25, 1946. (R. 49-50.) The petition for certiorari was filed October 25, 1946.

¹ Record references are to pages of the appendix to the brief for petitioner in the Circuit Court of Appeals.

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Did both the Tax Court and the Circuit Court of Appeals err in holding that the taxpayer, a personal holding company within the meaning of Section 501 (a) (2) of the Internal Revenue Code, which sold stock in various corporations to its principal stockholder at market prices for a lump sum, resulting in gains as to some and losses as to others, was taxable on the gains and was prohibited by Section 24 (b) (1) (B) of the Internal Revenue Code from offsetting losses against the gains and from claiming a deductible net loss for the year 1941?
2. Did the courts below err in holding that the taxpayer is subject to the personal holding company surtax imposed by Section 500 of the Internal Revenue Code, as amended by Section 110 (a) (2) of the Revenue Act of 1941, on its undistributed subchapter A net income and was prohibited by the provisions of Section 504 (a) from taking a credit as a deficit corporation under the provisions of Section 27 (a) (3)?

STATUTES INVOLVED

The applicable provisions of the statutes involved are set out in the Appendix, *infra*, pp. 12-14.

STATEMENT

The facts as found by the Tax Court may be summarized as follows:

The taxpayer, Morris Investment Corporation, was incorporated December 31, 1928, under the laws of Delaware. For the taxable year 1941 it filed a corporation income and declared value excess profits tax return and a personal holding company tax return. (R. 13-14.)

During the taxable year 1941 the taxpayer was a personal holding company. Mrs. Katherine Clark Morris was president of the taxpayer and during the taxable year 1941 owned 91.87 per cent of the 31,000 outstanding shares of its common capital stock. The remainder of the stock was held by the estate of her late husband, L. R. Morris, and by her daughter and son-in-law.² (R. 14.)

At a special meeting of the board of directors of the taxpayer, held on September 16, 1941, Mrs. Morris offered to purchase certain stocks³ owned

² Section 501 (a) (2) of the Internal Revenue Code defines a personal holding company as one in which more than 50 per centum in value of its outstanding stock is owned, directly or indirectly, by or for not more than five individuals.

³ These stocks were (R. 15) :

700 shares of capital stock of Amerada Corporation
150 shares of capital stock of American Telephone & Telegraph Company

500 shares of capital stock of Union Carbide & Carbon Corporation

25 shares of common stock of Atchison, Topeka & Santa Fe Railway Co.

by the company. (R. 14-15.) The offer was accepted. (R. 15.)

The purchase price was the aggregate of the market prices of the stocks sold, at the close of September 15, 1941. All the stocks were actively traded in on the New York Stock Exchange. A note for \$131,368.75, given by Mrs. Morris in payment, was never paid. (R. 16.)

With respect to the shares in American Telephone & Telegraph Company and Chesapeake & Ohio Railway Company, specific resolutions were adopted, providing that the company sell Mrs. Morris 150 shares of American Telephone & Telegraph Company stock at a price of 154 $\frac{5}{8}$ per share, and 200 shares of the common stock of the Chesapeake & Ohio Railway Company at a price of \$37.25 per share. (R. 16.)

The stocks purchased by Mrs. Morris were delivered to three trust companies in New York City with whom Mrs. Morris had arranged to establish trusts for the benefit of her daughter and her grandchildren. (R. 16.)

The following gains or losses resulting from the sale were reported by the taxpayer in its income tax return for the taxable year 1941 (R. 17):

-
- 200 shares of common stock of Chesapeake & Ohio Railway Company
 - 150 shares of common stock of Union Pacific Railroad Company
 - 150 shares of common stock of Corn Products Refining Company

Description of property	Date acquired	Gross sales price	Cost	Gain	Loss
100 American Telephone & Telegraph Co.	3/27/20	\$15,462.50	\$18,867.57		\$3,395.07
50 American Telephone & Telegraph Co.	1/30/33	7,731.25	5,216.75	\$2,514.50	
25 Atchison, Topeka & Santa Fe Ry. Co. Common	10/8/29	675.00	6,933.75		6,258.75
200 Amerada Corporation	4/17/34	11,800.00	10,072.50	1,727.50	
100 Amerada Corporation	4/18/34	5,900.00	5,292.50	607.50	
200 Amerada Corporation	4/21/34	11,800.00	10,585.00	1,215.00	
100 Amerada Corporation	5/14/34	5,900.00	4,690.00	1,210.00	
100 Amerada Corporation	7/30/34	5,900.00	4,290.00	1,610.00	
150 Corn Products Refining Corp. Common	1/30/33	7,875.00	8,313.04		438.04
200 Chesapeake & Ohio Ry. Common	2/2/33	7,450.00	5,780.00	1,670.00	
300 Union Carbide & Carbon Corporation	1/2/29	23,550.00	17,522.84	6,027.16	
100 Union Carbide & Carbon Corporation	9/9/29	7,850.00	12,662.14		4,812.14
32 Union Carbide & Carbon Corporation	10/17/29	2,512.00	3,425.02		913.02
68 Union Carbide & Carbon Corporation	3/25/30	5,338.00	6,635.10		1,297.10
150 Union Pacific R. R. Co. Common	1/30/33	11,625.00	11,290.75	334.25	
Total		\$131,368.75	\$131,566.96	\$16,915.91	\$17,114.12

In that return the taxpayer reported a net long-term capital loss of \$198.21. (R. 17.) The following statement was attached to the return (R. 18):

The stocks listed above, having a total acquisition cost of \$131,566.96, were sold and paid for at a total price of \$131,368.75 and delivered Sept. 16, 1941, to the purchaser, Mrs. K. Clark Morris, chief stockholder and president of this company, the prices being the market prices for said stocks at the close of September 15, 1941. The net loss realized on these sales was \$198.21.

The taxpayer kept no general investment account on its books. Each certificate of stock held by the taxpayer, including those sold to Mrs. Morris on September 16, 1941, was kept in a separate account on the company's books and accounted for separately, so that the taxpayer could tell what the adjusted acquisition cost of such certificate was at any time to apply against any ultimate realization, and to collate tax returns easily. After the sale to Mrs. Morris, entries were made in the separate accounts of each certificate on the books to record the sale. The amount entered as sale price was the price at which the stock had sold at the last sale prior to September 15, 1941. (R. 18.)

The taxpayer had a deficit of \$10,420.51 on December 31, 1940, and at the close of December 31, 1941, had a deficit of \$11,144.73. Its earnings were paid out at the end of the year. (R. 18.)

Under the provisions of Section 24 (b) (1) (B) of the Internal Revenue Code, the Commissioner denied the taxpayer any loss on the stocks sold to Mrs. Morris but included the gains as taxable income. (R. 13.) He determined that the taxpayer was subject to a personal holding company surtax and found a deficiency in income tax of \$6,965.89 and a deficiency in personal holding company surtax of \$13,301.67. (R. 13.)

The Tax Court sustained the deficiencies in tax as found by the Commissioner (R. 22), and the

Circuit Court of Appeals for the Third Circuit affirmed that decision (R. 50).

ARGUMENT

1. There is no conflict of decisions; and in view of the settled construction of the statutory provisions by the decided cases,⁵ there is no necessity for further review by this Court. The taxpayer's attempt to distinguish the cases relied upon by the Government was not convincing either to the Tax Court (R. 19-20) or to the Circuit Court of Appeals (R. 46-48).

The applicable statutes (Appendix, *infra*) are clear and unambiguous. The taxpayer is a personal holding company (R. 14) under the definition of Section 501 (a) (2) of the Internal Revenue Code. Being a personal holding company it is taxable on the gains derived from the sale of stock to its principal stockholder under Section 22 (a) of the Code and is prohibited by Section 24 (b) (1) (B) from offsetting losses on other stocks sold to its principal stockholder or from taking a deduction for any net loss. The decisions have laid down the rule that where there are sales of various securities for an aggregate

⁵ *M. F. Reddington Co. v. Commissioner*, 131 F. 2d 1014 (C. C. A. 2d); *Lakeside Irr. Co. v. Commissioner*, 128 F. 2d 418 (C. C. A. 5th), certiorari denied, 317 U. S. 666; *Mathews v. Squire*, 59 F. Supp. 827 (W. D. Wash.); *W. A. Drake, Inc. v. Commissioner*, 3 T. C. 33; *Mahaffey v. Commissioner*, 1 T. C. 176, reversed on another issue, 140 F. 2d 879 (C. C. A. 8th).

sum, the gain or loss on each block must be separately computed. The limitation prescribed by Section 24 (b) (1) (B) of the Code is clearly within the power of Congress since the allowance of deductions is not a matter of right but of legislative grace.⁶

The taxpayer admits (Br. 25) that its first and principal point (Br. 19-25) is inconsistent with the cases. Moreover, each purchase of a security results in a separate cost and a separate holding period. Therefore, it is proper to treat the disposition of each security as a separate transaction, whether or not it is sold in conjunction with others. Accordingly, the rule applied here is generally applicable, and differences in detail such as those relied upon by the taxpayer (Br. 32-37) do not distinguish the earlier cases. The rule applied herein is the general rule applicable in computing gain or loss in all sales of securities and is not confined in its application solely to personal holding companies.

Equally unsound are taxpayer's second (Br. 26) and fourth contentions (Br. 29-30) that by selling for a lump sum the separate securities were merged into a single and indivisible whole. Moreover, the Tax Court disagreed with the taxpayer's statement (Br. 13) that the transaction was an "*integral lump sum*" sale of several classes

⁶ *New Colonial Co. v. Helvering*, 292 U. S. 435, 440; *White v. United States*, 305 U. S. 281, 292; *Deputy v. du Pont*, 308 U. S. 488, 493.

of stock not separately priced". (R. 19-20.) By resolution, as to some of the stocks sold, the taxpayer made a division (R. 16) and it kept the various lots separately listed on its books showing the date of acquisition, gross sales price, cost and the resulting gain or loss from each lot sold (R. 17). See also Schedule C of the income tax return filed for the year 1941 showing separate treatment of each lot of stock sold. (R. 38-42.)

The taxpayer's third contention (Br. 27-28) erroneously assumes that authority for the rule applied here must be found in Section 24 (b) (1) (B). Even upon that assumption the application of the statute is not limited to bona fide sales or cases of subsequent control by the seller over the property sold but covers other situations as well.

The taxpayer's remaining points are likewise without merit. Its assertion (Br. 30) that it did not sell any of the stocks at a loss is not borne out by the record. (R. 17.) That the taxpayer intended to sell at cost (Br. 30-32) is beside the point since what was done is controlling.⁷

2. Lastly, the taxpayer argues (Br. 43-47) that the purpose of Sections 500-511 was to force distributions which would be taxable in the hands of stockholders. That undoubtedly was one of the purposes of the enactment but other cases also fall within the ambit of the statute. It is also

⁷ *Davidson v. Commissioner*, 305 U. S. 44, 46; *United States v. Safety Car Heating Co.*, 297 U. S. 88, 98.

contended (Pet. 7, Br. 16, 43-47) that, because the taxpayer was a deficit corporation without earnings to distribute, it is not subject to the personal holding company surtax. Section 27 (a) (3) of the Code allows a dividends paid credit to deficit corporations but that section does not apply to personal holding companies and the taxpayer is not entitled to any dividends paid credit in computing its undistributed subchapter A net income for the year 1941 although the taxpayer was a deficit corporation at the beginning and end of the year 1941.⁸

Subchapter A of Chapter 2 of the Code relates exclusively to personal holding companies and provides for a surtax on undistributed subchapter A net income of such companies. Section 504 of that subchapter defines the term undistributed subchapter A net income as subchapter A net income minus the amount of the dividends paid credit provided in Section 27 (a) without the benefit of paragraphs 3 and 4 thereof. The taxpayer here must rely upon Section 27 (a) (3) as a deficit corporation but Section 504 (a) of the Code expressly excludes a personal holding company from the benefits generally accorded a deficit corporation.

⁸ *Morris Inv. Corp. v. Commissioner*, 134 F. 2d 774, 775 (C. C. A. 3d), certiorari denied, 320 U. S. 743.

CONCLUSION

There is no conflict of decisions, and the decision of the Circuit Court of Appeals is correct; the petition for a writ of certiorari should therefore be denied.

Respectfully submitted,

GEORGE T. WASHINGTON,
Acting Solicitor General.

SEWALL KEY,
Acting Assistant Attorney General.

J. LOUIS MONARCH,
NEWTON K. FOX,

Special Assistants to the Attorney General.

NOVEMBER, 1946.

APPENDIX

Internal Revenue Code:

SEC. 22. GROSS INCOME.

(a) *General Definition.*—“Gross income” includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

* * * * *

(26 U. S. C. 22.)

SEC. 24. ITEMS NOT DEDUCTIBLE.

* * * * *

(b) *Losses from Sales or Exchanges of Property.*—

(1) *Losses Disallowed.*—In computing net income no deduction shall in any case be allowed in respect of losses from sales or exchanges of property, directly or indirectly—

* * * * *

(B) Except in the case of distributions in liquidation, between an individual and a corporation more than 50 per centum in

value of the outstanding stock of which is owned, directly or indirectly, by or for such individual; * * *

(26 U. S. C. 24.)

SEC. 27. CORPORATION DIVIDENDS PAID CREDIT.

(a) *Definition in General.*—As used in this chapter with respect to any taxable year the term "dividends paid credit" means the sum of:

* * * * *

(3) The amount, if any, by which any deficit in the accumulated earnings and profits, as of the close of the preceding taxable year (whether beginning on, before, or after January 1, 1939), exceeds the amount of the credit provided in section 26 (e) (relating to net operating losses), for such preceding taxable year (if beginning after December 31, 1937); * * *

* * * * *

(i) *Nontaxable Distributions.*—If any part of a distribution (including stock dividends and stock rights) is not a taxable dividend in the hands of such of the shareholders as are subject to taxation under this chapter for the period in which the distribution is made, such part shall not be included in computing the basic surtax credit.

(26 U. S. C. 27.)

SEC. 500 [as amended by Section 110 (a) (2) of the Revenue Act of 1941, c. 412, 55 Stat. 687]. SURTAX ON PERSONAL HOLDING COMPANIES.

There shall be levied, collected, and paid, for each taxable year beginning after De-

ember 31, 1938, upon the undistributed subchapter A net income of every personal holding company (in addition to the taxes imposed by chapter 1) a surtax equal to the sum of the following:

(1) $7\frac{1}{2}$ per centum of the amount thereof not in excess of \$2,000; plus

(2) $8\frac{1}{2}$ per centum of the amount thereof in excess of \$2,000.

(26 U. S. C. 500.)

SEC. 501. DEFINITION OF PERSONAL HOLDING COMPANY.

(a) *General Rule.*—For the purposes of this subchapter and chapter 1, the term "personal holding company" means any corporation if—

* * * * *

(2) *Stock Ownership Requirement.*—At any time during the last half of the taxable year more than 50 per centum in value of its outstanding stock is owned, directly or indirectly, by or for not more than five individuals.

* * * * *

(26 U. S. C. 501.)

SEC. 504. UNDISTRIBUTED SUBCHAPTER A NET INCOME.

For the purposes of this subchapter the term "undistributed subchapter A net income" means the subchapter A net income (as defined in section 505) minus—

(a) The amount of the dividends paid credit provided in section 27 (a) without the benefit of paragraphs (3) and (4) thereof.

* * * * *

(26 U. S. C. 504.)